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NEW ZEALAND EMBASSY
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5 May 1981

Dear Mr. Calingaert,

Further to our discussion this morning, we have put together the enclosed background notes on New Zealand's export trade in butter and related products. You may find them useful in the context of your consideration of the Department of Agriculture's proposals on subsidised export disposal sales of butter. Our formal position and concerns on the Department's proposals, as far as we understand them, were set out in the Aide Memoire which we left with you last week. Should you have any queries on the content of either the Aide Memoire or these notes please let me know.

I am sending a copy of the notes to Donald Nelson in USTR. Regards.

Yours sincerely,

A.C. Cranston
Minister (Commercial)

DEPARTMENT OF STATE A/CDC/MR
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Mr. Michael Calingaert,
Deputy Assistant Secretary,
International Resources and Food Policy,
Bureau of Economic & Business Affairs,
Room 3529,
Department of State,
Washington, D.C. 20520.

NOTES ON NEW ZEALAND'S TRADE IN BUTTER AND RELATED PRODUCTS

A. THE NEW ZEALAND DAIRY INDUSTRY

The dairy industry is of major importance to the New Zealand economy. In 1980 the industry earned $1,022 million in foreign exchange, 17.6 percent of New Zealand's total export income. With beef and associated by-products from the industry added, the contribution the dairy industry makes to the generation of export income is considerably greater.

The New Zealand industry is not a major one in terms of global production (producing only about 1.5 percent of estimated total world milk production). It does however have a major role in terms of dairy exporting. Some 89 percent of the milk produced in New Zealand is used in the manufacture of dairy products. Of total dairy products manufactured, aroun 88 percent are exported. The viability of the industry depends directly on the returns it is able to achieve from the sale of its products on the international market. No other dairy industry in the world is structured this way. (Although they are not so significant to their national economies and do not share the same degree of export orientation as the New Zealand industry, the dairy industries in Ireland and Denmark are significant exporters. Their trade is, however, largely within the highly protected confines of the EC and, in all cases, their returns are guaranteed by the Common Agriculture Policy).

International trade in dairy products is subject to political influence and trade distortion probably more than any other comparable product group. Access to the markets of all the major

industrialised countries including the United States is severely restricted. Outside these countries market opportunities and, in particular price levels, are subject to manipulation by the export subsidy practices of the major industrialised countries. There is really no such thing as a world or "free" dairy market but rather a series if highly segmented markets. Price levels in these markets (and therefore the level of supply and demand) are largely determined by politically-based decisions made in Brussels, Washington, Tokyo and elsewhere - through export subsidy practices, the impact of these decisions extends to outside market areas.

The New Zealand dairy industry must work within this environment which leaves it extremely vulnerable to changing politica fortunes. It has no option but to export and its exports are vital to the New Zealand economy. New Zealand has no major industrial sector to subsidise its dairy industry. It is in no position to compete with the Treasuries of the U.S., the E.C. and others in terms of establishing world prices for dairy products.

B. NEW ZEALAND BUTTER PRODUCTION

The vast bulk of the fat component of the milk processed by dairy factories in New Zealand is used in the production of butter products. On average, over the last four seasons, butter products have accounted for 79.5 percent of the total milk fat processed.

/TABLE I - MILK

TABLE I - MILK FAT PROCESSED BY DAIRY FACTORIES

(000 tonnes)

Year	Butter Products	Cheese	Other	Total
1976/77	225.8	33.3	16.0	275.1
1977/78	203.0	31.0	17.0	251.0
1978/79	217.1	33.6	23.5	274.2
1979/80 *	221.6	39.2	30.1	290.9
Average				

* provisional

Source N.Z. Dairy Board Annual Report

Butter and anhydrous milk fat (AMF - also known as butter oil/ghee) are the two principal butter products. Production in the most recent four seasons is summarised in the following table

TABLE II - DAIRY FACTORY MANUFACTURE

Year	Butter	AMF
1976/77	201,851	41,290
1977/78	192,307	38,881
1978/79	233,641	21,021
1979/80 *	220,413	42,488

* provisional

Source NZ Dairy Board Annual Report

Domestic consumption of butter in New Zealand, which has been relatively constant for many years, absorbs around 45,000 tonnes of production annually. The rest is exported. There is virtually no domestic consumption of AMF.

C. NEW ZEALAND'S EXPORTS OF BUTTER AND AMF

Britain has been the traditional market for New Zealand's exports of milkfat products. In 1969 New Zealand exports of

butter to Britain totalled 187,000 tonnes or 95.6 percent of total butter exports. In the same year cheese exports to Britain totalled 70,300 tonnes or 80.6 percent of total cheese exports.

Britain joined the EC in 1973 and since then market access for New Zealand's dairy exports has been subject to a special arrangement. Access has been phased down. Access for New Zealand cheese was phased out by 1978 although, as a result of the MTN, limited access was restored in 1980. For 1981, New Zealand's access for butter will be 94,000 tonnes.

This radical shift in position with respect to its traditional market has compelled New Zealand to diversify its export trade in milkfat products both in terms of markets and products. Improvements in the level and conditions of access to the major developed industrial markets have been pursued vigorously both bilaterally and multilaterally (New Zealand's access for butter to the U.S. market remains at 151 tonnes). New products such as wholemilk powder formulations have been developed which have a high fat content and the trade in AMF (used principally in the production of recombined milk in less developed countries) has been built up.

A number of factors have had a direct impact on New Zealand's ability to diversify. Apart from direct access questions, the subsidised export sales policies of the other major dairy producing countries have been the most important. New Zealand has had to meet competition from subsidised exports from countries such as Canada but of even more importance have been the export policies of the United States and particularly the E.C. The U.S. has for many years adhered to a policy of dealing with periodic

surplus accumulation problems internally and has not become involved in heavily subsidised dumping on the international market. New Zealand has worked closely with the EC both bilaterally and multilaterally in the GATT to ameliorate the worst effects of its export restitution system.

(New Zealand views the International Dairy Agreement negotiated in the MTN primarily as subsidy limitation arrangement. The degree of subsidisation is limited by the minimum export prices. Unfortunately at present the minimum prices remain far below the levels needed to ensure the maintenance of a minimum return to unsubsidised producers.)

D. THE INTERNATIONAL BUTTER MARKET

As a result of its diversification drive and its day-to-day involvement in the international dairy market, New Zealand has developed an intimate knowledge of the characteristics of the international butter market. Its principle features are as follows:

- It is extremely small in relation to world butter production. Reliable independent statistics are difficult to come by and various interpretations can be placed on those that are available. For example, much of the trade which the statistics show takes place is cross-border trade in Europe and is not, for practical reasons, open to outside suppliers. It is important to get behind the figures and look at the character of the butter trade to appreciate the severely limited size of the market.

- The apparent expansion of the market which has occurred in recent years can be attributed almost solely to increased and heavy purchases by the Soviet Union (mainly from the EC).

- Putting purchases by the Soviet Union to one side, significant new demand opportunities simply do not materialise in the short-run although the import requirements of some individiaul markets are subject to volatile swings.

- Butter is a storable product. Purchases made now need not be consumed for months or even years.

- The butter market is not a "commodity market" in the sense that this term is generally understood. Again, putting transactions with the Soviet Union to one side, sales of product in bulk are becoming increasingly less significant. Permanent suppliers are involved in purchasing countries with heavy investments in marketing structures, the development of branded products and other "demand creation" activities.

- While EC exports are heavily subsidised, traders exporting from the Community are involved in the market on a continuing basis and have worked positively to develop new market outlets.

- It is important to appreciate that the E.C.'s export trade in butter is not simply an export disposal operation (leaving aside sales to the East). Traders from, for example, Denmark and Ireland, have been involved in exporting dairy products on a continuing basis for many years. They were certainly involved before their respective countries joined the E.C. and their activities received the generous benefits of export restitutions. The E.C. has taken positive steps internally to control its dairy surplus problem. There is now a wide acceptance in the Community that attempts to export its surplus are both too expensive and ineffective.

- Much of the available statistical data on international butter trade includes trade in AMF. The two should not be confused. Butter can be readily transformed into AMF. The reverse is not the case.
- Much of the expansion of trade in AMF which has occurred in recent years has involved markets in Africa and the Middle East - particularly OPEC members.
- Market returns which are largely determined by non-market forces (see above) are subject to wide variation but, in general, are very low and much less than returns guaranteed to producers in the United States, Western Europe and Japan.

E. A LOOK AHEAD

Given the considerations outlined above, there is no doubt that the sudden availability of large quantities of bulk butter for export at heavily subsidised prices from the United States will severely impact on international market opportunities and price levels.

The New Zealand Dairy Board is currently involved in negotiating sales arrangements (particularly price) for the ~~far~~ first half of the 1981/82 season. Assuming an average level of production in 1981/82, New Zealand will produce around 210,000 tonnes of butter and around 35,000 tonnes of AMF. Around 45,000 tonnes of butter will be consumed internally. Another 94,000 tonnes will be exported to Britain. The Board will therefore have to find other markets for approximately 70,000 tonnes of butter and 45,000 tonnes of AMF. The opportunities are already strictly limited. Development of new markets is extremely difficult, and a long term process.

One of the few areas offering new potential is the Middle East.

Of equal importance are the level of returns the Dairy Board is able to achieve both for the New Zealand economy and the New Zealand dairy farmers. A price collapse precipitated by short-term disposal operations of others would immediately shift the burden of needed adjustments to internal U.S. programmes to the New Zealand economy and the New Zealand dairy industry. Actions which foreclosed on further price increases on the international dairy market would clearly also impact severely on New Zealand and the New Zealand dairy industry.

Office of the Minister Commercial,
New Zealand Embassy,
WASHINGTON D.C.

5 May 1981